

Chapter 1 of the Code, in addition to the deductions provided in part VI (section 161 and following) Subchapter B, Chapter 1 of the Code.

§ 1.242-1 Deduction for partially tax-exempt interest.

A corporation is allowed a deduction under section 242(a) in an amount equal to certain interest received on obligations of the United States, or an obligation of corporations organized under Acts of Congress which are instrumentalities of the United States. The interest for which a deduction shall be allowed is interest which is included in gross income and which is exempt from normal tax under the act, as amended and supplemented, which authorized the issuance of the obligations. The deduction allowed by section 242(a) is allowed only for the purpose of computing normal tax, and therefore, no deduction is allowed for such interest in the computation of any surtax imposed by Subtitle A of the Internal Revenue Code of 1954.

[T.D. 7100, 36 FR 5333, Mar. 20, 1971]

§ 1.243-1 Deduction for dividends received by corporations.

(a)(1) A corporation is allowed a deduction under section 243 for dividends received from a domestic corporation which is subject to taxation under Chapter 1 of the Internal Revenue Code of 1954.

(2) Except as provided in section 243(c) and in section 246, the deduction is:

(i) For the taxable year, an amount equal to 85 percent of the dividends received from such domestic corporations during the taxable year (other than dividends to which subdivision (ii) or (iii) of this subparagraph applies).

(ii) For a taxable year beginning after September 2, 1958, an amount equal to 100 percent of the dividends received from such domestic corporations if at the time of receipt of such dividends the recipient corporation is a Federal licensee under the Small Business Investment Act of 1958 (15 U.S.C. ch. 14B). However, to claim the deduction provided by section 243(a)(2) the company must file with its return a statement that it was a Federal licensee under the Small Business In-

vestment Act of 1958 at the time of the receipt of the dividends.

(iii) For a taxable year ending after December 31, 1963, an amount equal to 100 percent of the dividends received which are *qualifying dividends*, as defined in section 243(b) and § 1.243-4.

(3) To determine the amount of the distribution to a recipient corporation and the amount of the dividend, see §§ 1.301-1 and 1.316-1.

(b) For limitation on the dividends received deduction, see section 246 and the regulations thereunder.

[T.D. 6992, 34 FR 817, Jan. 18, 1969]

§ 1.243-2 Special rules for certain distributions.

(a) *Dividends paid by mutual savings banks, etc.* In determining the deduction provided in section 243(a), any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, cooperative banks, and domestic building and loan associations) shall not be considered as a dividend.

(b) *Dividends received from regulated investment companies.* In determining the deduction provided in section 243(a), dividends received from a regulated investment company shall be subject to the limitations provided in section 854.

(c) *Dividends received from real estate investment trusts.* See section 857(c) and paragraph (d) of § 1.857-6 for special rules which deny a deduction under section 243 in the case of dividends received from a real estate investment trust with respect to a taxable year for which such trust is taxable under Part II, Subchapter M, Chapter 1 of the Code.

(d) *Dividends received on preferred stock of a public utility.* The deduction allowed by section 243(a) shall be determined without regard to any dividends described in section 244 (relating to dividends on the preferred stock of a public utility). That is, such deduction shall be determined without regard to any dividends received on the preferred stock of a public utility which is subject to taxation under Chapter 1 of the Code and with respect to which a deduction is allowed by section 247 (relating to dividends paid on certain preferred stock of public utilities). For a

deduction with respect to such dividends received on the preferred stock of a public utility, see section 244. If a deduction for dividends paid is not allowable to the distributing corporation under section 247 with respect to the dividends on its preferred stock, such dividends received from a domestic public utility corporation subject to taxation under Chapter 1 of the Code are includible in determining the deduction allowed by section 243(a).

[T.D. 6598, 27 FR 4092, Apr. 28, 1962, as amended by T.D. 6992, 34 FR 817, Jan. 18, 1969; T.D. 7767, 46 FR 11264, Feb. 6, 1981]

§ 1.243-3 Certain dividends from foreign corporations.

(a) *In general.* (1) In determining the deduction provided in section 243(a), section 243(d) provides that a dividend received from a foreign corporation after December 31, 1959, shall be treated as a dividend from a domestic corporation which is subject to taxation under chapter 1 of the Code, but only to the extent that such dividend is out of earnings and profits accumulated by a domestic corporation during a period with respect to which such domestic corporation was subject to taxation under Chapter 1 of the Code (or corresponding provisions of prior law). Thus, for example, if a domestic corporation accumulates earnings and profits during a period or periods with respect to which it is subject to taxation under Chapter 1 of the Code (or corresponding provisions of prior law) and subsequently such domestic corporation reincorporates in a foreign country, any dividends paid out of such earnings and profits after such reincorporation are eligible for the deduction provided in section 243(a) (1) and (2).

(2) Section 243(d) and this section do not apply to dividends paid out of earnings and profits accumulated (i) by a corporation organized under the China Trade Act, 1922, (ii) by a domestic corporation during any period with respect to which such corporation was exempt from taxation under section 501 (relating to certain charitable, etc. organizations) or 521 (relating to farmers' cooperative associations), or (iii) by a domestic corporation during any period to which section 931 (relating to in-

come from sources within possessions of the United States) applied.

(b) *Establishing separate earnings and profits accounts.* A foreign corporation shall, for purposes of section 243(d), maintain a separate account for earnings and profits to which it succeeds which were accumulated by a domestic corporation, and such foreign corporation shall treat such earnings and profits as having been accumulated during the accounting periods in which earned by such domestic corporation. Such foreign corporation shall also maintain such a separate account for the earnings and profits, or deficit in earnings and profits, accumulated by it or accumulated by any other corporations to the earnings and profits of which it succeeds.

(c) *Effect of dividends on earnings and profits accounts.* Dividends paid out of the accumulated earnings and profits (see section 316(a)(1) of such foreign corporation shall be treated as having been paid out of the most recently accumulated earnings and profits of such corporation. A deficit in an earnings and profits account for any accounting period shall reduce the most recently accumulated earnings and profits for a prior accounting period in such account. If there are no accumulated earnings and profits in an earnings and profits account because of a deficit incurred in a prior accounting period, such deficit must be restored before earnings and profits can be accumulated in a subsequent accounting period. If a dividend is paid out of earnings and profits of a foreign corporation which maintains two or more accounts (established under the provisions of paragraph (b) of this section) with respect to two or more accounting periods ending on the same day, then the portion of such dividend considered as paid out of each account shall be the same proportion of the total dividend as the amount of earnings and profits in that account bears to the sum of the earnings and profits in all such accounts.

(d) *Illustration.* The application of the principles of this section in the determination of the amount of the dividends received deduction may be illustrated by the following example: